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SUBJECT: KAZAKHSTAN: LOCAL CONTENT LEGISLATION AMENDMENTS NEEDED  
TO KEEP OIL AND GAS PROJECTS ON TRACK

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REFTEL: 08 ASTANA 1910

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On January 20, Energy Officer received a thorough overview of the laws and regulations governing subsoil use and local content from a well-respected local law firm. Negotiations between the government and foreign investors over local content likely will continue due to ambiguous language in the law, which fails to define a consistent methodology to calculate local content. If unresolved, these negotiations could affect the quality and pace of major oil-production projects, such as Kashagan. END SUMMARY.

#### LEGISLATION REGULATING SUBSOIL USER OPERATIONS

13. (SBU) On January 20, Energy Officer met with Samat Daumov, Director of the Astana Branch of Grata Law Firm and a member of the Parliamentary advisory group on the Subsoil Use Law, to discuss subsoil use legislation. The discussion included Decree 367 (March 20, 2009) to establish a unified methodology for local content calculation, the Local Content Law 223 (December 29, 2009), and the draft Subsoil Use Law, which will replace existing laws. The Local Content Law officially comes into effect on January 22.

#### AMBIGUOUS METHODOLOGY LEADS TO INDIVIDUAL INTERPRETATIONS

14. (SBU) Daumov complained that ambiguity with the formula to calculate local content has compelled subsoil users to develop their own, individual interpretations and estimations. He asserted that the flawed formula resulted from government pressure for rapid legislative approval, which precluded parliament's proper consideration of the consequences of implementation. According to Daumov, the Ministry of Energy and Mineral Resources (MEMR) is awaiting the reaction of subsoil users to the new law, and "will not make further amendments unless they raise a fuss."

#### LOCAL CONTENT LAW STRENGTHENS STATE ROLE

15. (SBU) Daumov highlighted the Local Content Law's mandated creation of a database of local suppliers. He also explained that the law places responsibility for meeting local content requirements squarely on the shoulders of the companies and strengthens the state's oversight role by giving additional authority to the Ministry of Energy and Mineral Resources (MEMR) to monitor local content requirements. According to Daumov, the law requires companies to establish a percentage of local content in contracts, but does not explain how to address existing contracts without a specified percentage. Daumov confided that in March 2009, following approval of Decree 367, MEMR sent letters to subsoil users, which recommended they amend contracts to establish a minimum local-content provision. He asserted that small subsoil users undertook the relevant changes while larger investors did not.

16. NOTE: On January 26, Minister of Energy and Mineral Resources Sauat Mynbayev informed parliament that MEMR has introduced changes to more than 500 contracts during the past two years, including changes designed to increase local content and attract more Kazakhstani specialists to oil and gas projects. Mynbayev acknowledged that it has been difficult for MEMR to modify contracts for large projects such as Kashagan, but he nevertheless reported that the number of Kazakhstani senior managers working on Kashagan increased from nine to 241 during the last two years. "We will continue to press this point with the international companies," Mynbayev vowed, adding that all new exploration and production contracts will contain strict requirements to employ local subcontractors and Kazakhstani specialists. END NOTE.

17. (SBU) Daumov explained that the Local Content Law allows the state to revoke the subsoil-production rights of users who do not meet local-content requirements during a project's exploration

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phase. He said that the government, which is aware of Kazakhstan's current scarcity of qualified local-specialists and subcontractors, has asked international investors to establish consortia to develop local content. Although he acknowledged that the law favors domestic suppliers by creating an enabling environment for their development, Daumov contended that it does not constitute a direct subsidy.

#### SUBSOIL USE LAW NEAR FINAL APPROVAL

18. (SBU) Daumov told Energy Officer that discussion of the draft was temporarily halted pending approval of the Local Content Law. On January 21, the Parliament concluded debate on the draft Subsoil Use Law, which is expected to enter into force in the near future (reftel).

#### U.S. COMPANY CALLS FOR KAZAKHSTAN TO INVEST IN LOCAL CONTENT

19. (SBU) During a courtesy call with the Ambassador on January 26, Dan Houser, Vice President for Europe and Central Asia of J. Ray McDermott, told the Ambassador that McDermott was committed to investing in local content in Kazakhstan, but he said the government cannot continue to rely on international companies to develop local skills and capacity. "Kazakhstan needs to invest in itself more. They need to put their money on the table," he said.

110. (SBU) COMMENT: Although legislation governing local content and subsoil use gradually is taking shape, ambiguities regarding the calculation and implementation of local-content requirements present an administrative barrier for subsoil-use operations. Ongoing negotiations over what does and does not constitute local content could slow the pace of major oil projects, such as Kashagan, unless these issues are resolved in a timely manner. The government has previously demonstrated a willingness to consider the suggestions of subsoil users when implementing laws of this nature. We expect that further amendments will be necessary, particularly if large investors such as Chevron, ExxonMobil, and Conoco press the claim that these restrictions will impact the pace and quality of operations. END COMMENT.

